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C O N F I D E N T I A L SECTION 01 OF 02 CAIRO 004377

SIPDIS

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TAGS: [ENRG](#) [EPET](#) [ECON](#) [PGOV](#) [EG](#)

SUBJECT: SCENESETTER FOR SECRETARY OF ENERGY BODMAN VISIT
TO EGYPT, JULY 18-19, 2006

Classified By: DCM Stuart Jones for Reasons 1.4 (b) and (d)

Secretary Bodman

SIPDIS

1. (C) The U.S. Mission in Egypt warmly welcomes your visit to Cairo. It provides us the opportunity to enhance the investment climate and opportunities for U.S. corporations operating in Egypt's vital petroleum sector. Your meetings with Minister of Finance Yousef Boutros Ghali and Minister of Petroleum Sameh Fahmy will allow you to raise the two primary issues facing U.S. investors here: 1) arrears to producers from the national oil company, and 2) fuel subsidies that impinge the profitability of downstream retailers. The meeting with Minister Fahmy will also provide an update on developments regarding natural gas fields offshore of Gaza.

Getting Paid

2. (C) Apache Oil, the largest U.S. investor in Egypt, currently has over USD 3.1 billion invested in exploration and production in Egypt, and has plans to double its production over the next five years, with an additional USD 3.6 billion in investment. Apache continues to experience delayed payments from Egypt's state-owned Egyptian General Petroleum Company (EGPC), at times reaching upwards of USD 100 million. Apache is not alone. EGPC "plays the float" with all the multinationals. You may wish to reaffirm with Minister Fahmy that a good way to encourage new investment in a vital sector is to treat current investors well -- payments in arrears do the opposite.

Subsidies

3. (U) Gasoline prices in Egypt are five to seven times lower than comparable markets in the region, placing gasoline here among the cheapest in the world. A liter of 90 octane gasoline costs LE 1 (USD 17 cents). Official GOE estimates place the cost of the subsidy at LE 40 billion per year (USD 7 billion), although these estimates were made at a time of USD 50 per barrel oil. Fuels costs are set nationally, and the price of 90 octane gasoline has remained static for fourteen years. The GOE did, however, increase the price of diesel fuel in 2004 by nearly 50 percent with negligible flow-through effects on the costs of services. In the absence of market pricing, and with all possible efficiencies exploited, downstream retailers require a margin increase to squeeze any profitability from their retail operations. Such a margin increase would require a reduction of the fuel subsidy, however.

4. (C) Plans are reportedly afoot in the Cabinet to raise the price of 90 octane fuel to LE 1.30 (USD 23 cents), a 30 percent rise, thereby making it just slightly less expensive than the higher grade 92 octane. While this move would only negligibly affect the overall subsidy, it would be a major boost to downstream retailers. Exxon-Mobil, for one, has plans to invest an additional USD 100 million in Egypt over the next 6-7 years to upgrade service stations and other aspects of its retail business. This plan, however, is based on an assumption that the GOE will reduce the subsidy and move to more reasonable pricing. The GOE will be wary of any moves that could spur domestic unrest, however.

Gaza

5. (C) Your meeting with the Minister of Petroleum will also provide an opportunity to seek his views on the development of natural gas fields offshore of Gaza and plans to bring this gas ashore in Egypt. According to industry contacts, British Gas' (BG) recently-announced intention to bring natural gas production from the Gaza Marine field into Egypt is on hold due to Israeli non-cooperation on permit requests. The Palestinian Authority granted BG a 25-year concession in 2000 to develop the field, which lies twenty kilometers off

the Gaza coast, and BG has successfully fought off Israeli court challenges questioning the validity of the concession. The field is estimated to contain 1 trillion cubic feet of gas and, according to BG estimates, could be worth USD 100 million annually in taxes and royalties for the PA government. Initial negotiations with the GOI to bring the Gaza to Israel broke down due to disagreements over price and Israeli worries about revenues being used to finance Palestinian terrorism. Recent events in Gaza and Lebanon do not bode well for a speedy resolution. Separately, Egypt inked a deal with Israel in 2005 to sell 1.7 billion cubic meters of gas annually over 15 years through a pipeline under construction by the Egyptian-Israeli consortium Eastern Mediterranean Gas (EMG).

16. (C) Further development of the site requires ship-based surveys. Given the location of the site, the Israeli Ministry of Defense must permit the survey ship to pass through a small military-controlled zone near the Egypt-Gaza border. Despite past approvals, BG says that the Israeli MOD has failed to respond to the current request. Even though Egyptian proven gas reserves have doubled over the last seven years, multinational firms here believe that increasing domestic consumption and slowing production increases could force a tightening of supply as early as 2009, thereby reducing LNG exports, and much-needed revenues, from the two LNG "train" facilities located at Idku.

17. (C) On the political and security front, Egypt remains fully engaged on Gaza security issues since Israel's withdrawal of troops and settlers from the Gaza Strip last September. Egypt's decision to create a new Border Security Force of 1,000 trained and well-armed personnel troops for the Gaza border provided Israel with the confidence necessary for it to depart Gaza at that time. Egypt has improved its capacity to prevent cross-border smuggling into Gaza, and has worked to faithfully implement the November 15, 2005 Agreement on Movement and Access - brokered by Secretary Rice - that provided Gazans an international border outside Israel for the first time since 1967. Egypt also plays a unique and activist role in dealing with Palestinian political and armed factions, including efforts to broker a cease-fire with Israel and to resolve the crisis sparked June 25 when an Israeli soldier was kidnapped by Palestinian militants. Nonetheless, you will find your counterparts dismayed by Israeli military action in Lebanon.

Energy Sector Developments

18. (SBU) Gas exploration, development, and production are among the brightest spots in the economy, and gas exports increased significantly in 2005 as new liquefied natural gas (LNG) plants came on line in the Nile Delta, the Western Desert and offshore in the Mediterranean. Oil production and exports, while declining, still play an important role in the economy. In FY 04/05 the oil and gas sector officially accounted for approximately 12 percent of GDP and more than one third of annual merchandise exports. In the first half of FY 05/06, earnings from oil and gas exports amounted to about USD 4.8 billion, a 75 percent increase over the same period in the previous fiscal year. The oil and gas sector continues to account for the bulk of foreign investment in Egypt, with participation from industry giants such as British Petroleum (BP), British Gas (BG), Italy's ENI, and Shell, as well as leading independent producers such as U.S.-based Apache. A number of other U.S.-based exploration, drilling, and oilfield services companies also work in Egypt, and this sector continues to present some of the country's best trade and investment opportunities.

19. (SBU) Crude oil production has been in decline for some years, from a high of more than 920,000 barrels per day (BPD) in 1995 to an average of slightly higher than 655,000 BPD in the first ten months of 2005. In 2006 Egypt became a net oil importer. Gas and gas condensate production and reserves continue to rise. Over the last five years, production of natural gas has increased by approximately 75 percent, reaching more than 5.1 billion cubic feet per day by the end of 2005. Proven reserves have almost tripled over the past ten years to more than 65 trillion cubic feet (TCF). The government estimates probable reserves at another 40-60 TCF, but other industry sources are less confident of this figure.

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